VZCZCXYZ0000
OO RUEHWEB

DE RUEHKG #0759/01 3481938
ZNY CCCCC ZZH
O 141938Z DEC 09
FM AMEMBASSY KINGSTON
TO RUEHC/SECSTATE WASHDC IMMEDIATE 0390
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC IMMEDIATE
RUEHDG/AMEMBASSY SANTO DOMINGO IMMEDIATE
RUEHLO/AMEMBASSY LONDON IMMEDIATE 0118
RUEHOT/AMEMBASSY OTTAWA IMMEDIATE
RUEHCV/AMEMBASSY CARACAS
RUEHKG/AMEMBASSY KINGSTON

C O N F I D E N T I A L KINGSTON 000759

SIPDIS
STATE FOR WHA/CAR (VDEPIRRO) (WSMITH) (JMACK-WILSON)
WHA/EPSC (MROONEY) (FCORNEILLE)
EEB/TRA (VLIMAYE-DAVIS)
EEB/ESC/IEC (GGRIFFIN)
EEB/IFD/ODF (MSIEMER)
EEB/ESC/IEC/EPC (MMCMANUS)
INR/RES (RWARNER)
INR/I (SMCCORMICK)
SANTO DOMINGO FOR FCS AND FAS
TREASURY FOR ERIN NEPHEW
EXPORT IMPORT BANK FOR ANNETTE MARESH
USTDA FOR NATHAN YOUNG AND PATRICIA ARRIAGADA
OPIC FOR ALISON GERMAK

E.O. 12958: DECL: 2034/12/14
TAGS: ECON EFIN EAIR EINV SOCI PREL PINR TRSY IDB IMF JM
XL
SUBJECT: JAMAICA: ON THE BRINK OF AN IMF DEAL

REF: KINGSTON 956; KINGSTON 737; KINGSTON 743; KINGSTON 622
KINGSTON 800; KINGSTON 315

CLASSIFIED BY: Isiah Parnell, CDA; REASON: 1.4(B), (D)

Summary

¶1. (C) The Government of Jamaica (GOJ) appears on the verge of pursuing a selective default with local debt holders in order to secure a much needed Standby Agreement with the International Monetary Fund (IMF). Prime Minister Bruce Golding has been adamant in wanting to avoid any blemish on the country's flawless credit history, but necessity has forced him to accept harsh realities. PM Golding is keen to demonstrate to taxpayers, who for years have had a majority of their tax payments used for debt servicing, that local bondholders will now be required to shoulder at least some of the burden in reducing Jamaica's indebtedness. For years, local bondholders have derived substantial returns from low-risk, high-yield debt instruments. However, taxpayers will not be spared as PM Golding, for the third time in nine months, announced plans for a new tax package effective January 1. End Summary

IMF Team Arrives For Final Trip?

¶2. (C) The IMF team arrived on December 12, once again led by IMF Caribbean Division Chief, Trevor Alleyne (Reftels A and B). Local press mistakenly reported that the team had arrived December 9 as originally scheduled; however, the team was delayed because of a disagreement among its team members regarding the execution of the debt operation. According to Ministry of Finance contacts close to the deal, some of the financial experts from the IMF team fear that the debt operation could have adverse affects on weaker entities in the financial services sector. Other members of the team accept this risk, but believe that a watered down solution would only provide momentary relief, and might require even more serious

measures in the future. As it stands, the GOJ appears set to pursue a "voluntary "debt exchange with lower coupons and extended maturities, and this could affect the balance sheet of some of the more vulnerable financial institutions, potentially leading to a contagion effect that could cause a run on the financial sector as investors lose confidence in the system, increasing the risk of capital flight.

¶3. (C) GOJ and the IMF recognize that the national airline Air Jamaica needs to be privatized; however, timing is an issue, given the costs associated with divestment. Most of the costs will be short term in nature and cannot be absorbed in the current fiscal year. This will require some creative solutions if Air Jamaica is to be sold this year as expected, and may require pushing some debts into the next fiscal year (Reftel C). Also, the proposed USD 1 billion PetroJam refinery expansion could be postponed, as the IMF is unwilling to have the GOJ provide a sovereign guarantee for the project. This is not likely to be well received by the Government of Venezuela, which recently purchased a 49 percent stake in the refinery, and could have implications for Jamaica's benefits under the PetroCaribe agreement (Reftel D).

New Taxes On The Way

¶4. (C) In an attempt to close the current budget gap of JMD 10 billion (USD 110 million) the GOJ is set to announce another major tax package to come into effect January 1. This is the third tax increase for the fiscal year and follows closely on the heels of an October increase, but given that revenue collections are anticipated to remain below expectations it is likely that even with the tax increase there will still be a sizable budget shortfall by the end of the fiscal year on March 31, 2010 (Reftel E). The tax package is expected to be comprised largely of an increase in the general consumption tax (GCT) and the special consumption tax (SCT) on fuel. The GCT rate, currently at 16.5 percent, may rise closer to 18 percent, while the SCT on fuel will be increased by JMD 8.75 (USD 0.10) the same amount by which it was increased in April (Reftel F). At that time, there was widespread concern the SCT increase could lead to social unrest, but fortunately there were only a few isolated incidents. However, with economic conditions worsening since April, the GOJ is likely to be even more concerned about an explosive public reaction to the tax hike.

Public Sector Cuts

¶5. (C) The income tax threshold may also be increased which would provide relief to many low income taxpayers and mitigate some of the impact of the GCT and SCT increases. (NOTE The GOJ still only collects about 50 percent of the tax revenue that is owed. End Note). There are also expected to be public sector layoffs and a three-year wage freeze. Public sector wages are second only to debt servicing in terms of total budget expenditures. During the two years of PM Golding's term, public sector wages have increased by almost fifty percent, although PM Golding has frequently highlighted the fact that these wage increases were contractual obligations he inherited from the previous Peoples' National Party-led administration.

Comment

¶6. (C) After several months of vacillating and numerous speeches in which he hinted at major reforms on the horizon, PM Golding finally appears ready to act decisively. He is set to make another defining speech in Parliament on December 15, which is the last sitting of Parliament for the 2009 session; hopefully, it will include the specifics that both the private sector and the public have been anticipating. However, the Jamaican economy is still in severe recession; the imposition of these new tax increases could send the economy deeper into the abyss if the private sector is unable to cope with additional burdens. End Comment.

Parnell